

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
Land Division
Honolulu, Hawaii 96813

February 8, 2008

Board of Land and Natural Resources
State of Hawaii
Honolulu, Hawaii

PSF No:02od-513
Oahu

Affirm Appraisal Methodology to Determine Shoreline Easement Consideration
for John Dunham & Dana Lynn Kawano, Kaneohe, Koolaupoko, Oahu, TMK (1)
4-6-01:27 seaward

BACKGROUND:

At its meeting on January 24, 2003, under agenda item D-6, the Board approved the issuance of a term non-exclusive easement for seawall, stairs and fill land to Edwin Lau, at the subject site (see Exhibit A). The Chairperson approved an appraisal on July 23, 2003, but the applicant did not accept the offer.

At its meeting on July 28, 2006, under agenda item D-5, the Board amended the prior Board action of January 24, 2003, to request a new appraisal based on the current date and to replace the name of the applicant with John P. Dunham and Dana Lynn Kawano, the new owners. These applicants have also rejected the offer based on the appraisal obtained pursuant to the July 28, 2006 Board action.

REMARKS:

Pursuant to the July 28, 2006 Board approval, the Chairperson approved the appraisal on December 29, 2006 with a valuation of a one-time payment of \$186,000 for the 55-year term non-exclusive easement. An offer letter was mailed to James Stone, the attorney representing the applicants. Mr. Stone rejected this offer by letter, dated February 2, 2007, demanding arbitration and appointing George D. Hao as the applicant's appraiser. Staff responded by letter dated April 11, 2007 that the arbitration process was to begin and instructed Mr. Stone to have his client's appraiser, Mr. Hao, contact the State's appraiser. Several months passed without any communication to the State regarding the arbitration process. Several attempts to contact Mr. Stone were unsuccessful. Finally, staff wrote to Mr. Stone via certified letter dated December 24, 2007 recapping the previous correspondence, stating that there had not been any communication from the applicant's side since a phone conversation in October 2007 and advising the applicants of staff's intent to rescind the prior Board action granting the term, non-

exclusive easement (see Exhibit B). Only after staff sent a certified letter did Mr. Stone respond to staff's inquiries. Even though the effective date of the appraisal is July 28, 2006, staff recommends the State should still agree to proceed with the arbitration process.

Mr. Stone has recently verbally expressed to staff that he does not believe the shoreline encroachment methodology approved by the Land Board is applicable to his clients (see Exhibit C). The methodology, approved by the Land Board on April 23, 2004, in agenda item D-13, was formulated to address shoreline encroachments abutting residential fast land. A consultant who had an extensive background in easement valuation was hired in early 2004 to address the increasing number of shoreline encroachments such as seawalls, revetments, ramps, stairs, groins, and breakwaters. Many of these encroachments were relatively small in terms of area.

The consultant indicated in his report referenced in the April 23, 2004 Board submittal that the most accurate and efficient method of handling the valuation of these term encroachment easements is to hire an independent appraiser. He also reasoned that instead of hiring commercial appraisers who generally charge at least \$2,000 to \$3,000 to value these easements, hiring a residential appraiser for around \$450 to value the adjacent residential land in a form appraisal would be more efficient and economical. In deriving a formula to calculate the market value of the term easement, the consultant based his methodology on that used in the Kaneohe Bay Pier Amnesty Program, which used real property tax assessed value as part of the formula to determine the pier easement consideration. This formula was tweaked by the consultant to improve accuracy; the appraised unit value of the adjacent residential land is inserted into the formula as opposed to the tax assessed value, which is the case in the Kaneohe Bay Pier formula.

This methodology has been used consistently since its inception in 2004 for all shoreline encroachments abutting residential property. In the interest of consistency and fairness to all applicants applying for shoreline encroachment easements, staff believes it should not offer the applicant a choice between using the Board approved methodology and obtaining their own appraisal of the easement value. Applicants who are given such a choice may choose the method most advantageous to them and convolute the process. Staff believes this would not be in the best interest of the State.

Staff recommends that applicants accept the appraised value of the subject easement or proceed with the arbitration process. The arbitration process shall conclude the market value of the adjacent residential fast land. Upon receiving the arbitrated value of the adjacent residential fast land, staff shall insert that appraised unit value into the Board approved formula to derive the value of the subject shoreline encroachment easement.

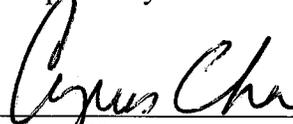
If applicant does not proceed with the arbitration process within 30 days of this Board action, staff recommends an automatic rescinding of the prior Board action and demanding that the seawall, stairs and fill land encroachment be removed to the State's satisfaction. In this instance, the applicants shall face fines in accordance with Hawaii Revised Statutes, §171-6(12), at \$500

per day.

RECOMMENDATION: That the Board, subject to the terms and conditions cited above, which are by this reference incorporated herein and further subject to the following:

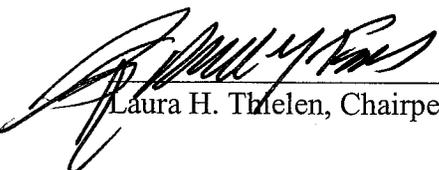
1. Require applicant to accept the current appraised value of the term non-exclusive encroachment easement for seawall, stairs and fill land; or
2. That should the applicant reject the current appraised value, require that the applicant provide written instruction to his appraiser within 30 days of this Board action to proceed with arbitration of the adjacent residential fast land;
3. That should the applicant fail to commence with the arbitration procedure within 30 days of this Board action, the prior Board action of January 24, 2003, under agenda item D-6 and July 28, 2006, under agenda item D-5 shall be automatically rescinded;
4. That should the prior Board action of January 24, 2003, under agenda item D-6 and July 28, 2006, under agenda item D-5 be rescinded, require the applicant to remove the seawall, stairs and fill land encroachment to the State's satisfaction within forty-five (45) days of the date of the rescinded Board action;
5. In the event of failure of John P. Dunham and Dana Lynn Kawano to comply with any order herein, they shall be fined \$500 per day until the order is complied with; and
6. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.

Respectfully Submitted,



Cyrus Chen
Appraisal Manager

APPROVED FOR SUBMITTAL:



Laura H. Thelen, Chairperson

EXHIBIT "A"

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
Land Division
Honolulu, Hawaii 96813

July 28, 2006

Board of Land and Natural Resources
State of Hawaii
Honolulu, Hawaii

02od-513

Oahu

Amend Prior Board Action of January 24, 2003, under Agenda Item D-6, for Grant of Term Non-Exclusive Easement to Edwin Lau, Kaneohe, Oahu, TMK: 1st/ 4-6-01:27 Seaward

REMARKS:

On January 24, 2003, under agenda item D-6, the Board authorized the issuance of a term, non-exclusive easement to Edwin Lau for an encroachment that includes a seawall, stairs and reclaimed land. A copy of the subject-approved submittal is attached as Exhibit A.

An appraisal, contracted by the State but paid by the applicant, was received and approved by the Department of Land and Natural Resources on July 25, 2003 but was rejected by Mr. Lau. However, he did not appoint another appraiser to pursue the arbitration process. The property was subsequently sold to John P. Dunham and Dana Lynn Kawano, as Trustees of the Dunham/Kawano Trust, whose address is 199 State Street, San Mateo, California 94401. The new owners want to resolve the encroachment, and request Board approval for a grant of easement to be issued in their name.

Staff recommends a new appraisal be done on this request since the previous one is no longer relevant due to changing market conditions.

The applicant has not had a lease, permit, easement or other disposition of State lands terminated within the last five years due to non-compliance with such terms and conditions.

RECOMMENDATION:

That the Board amend the prior Board action of January 24, 2003, under agenda item D-6 as follows:

1. Request a new appraisal based on the July 28, 2006 valuation date, to be paid for by the applicant;
2. Replace Edwin Lau, Applicant, with John P. Dunham and Dana Lynn Kawano, as Trustees of the Dunham/Kawano Trust,

APPROVED BY THE BOARD OF
LAND AND NATURAL RESOURCES
AT ITS MEETING HELD ON

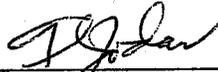
ITEM D-5

July 28, 2006

Applicant; and

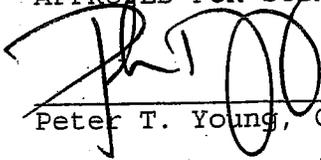
3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.

Respectfully Submitted,



Al Jodar
Land Agent

APPROVED FOR SUBMITTAL:



Peter T. Young, Chairperson

D-6

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
Land Division
Honolulu, Hawaii 96813

--January 24, 2003

Board of Land and Natural Resources
State of Hawaii
Honolulu, Hawaii

PSF No.: 02od-513

OAHU

Grant of a Term Non-exclusive Easement for Seawall, stairs and fill land to Edward Lau, Kaneohe, Koolaupoko, Oahu, Tax Map Key (1) 4-6-01:27

APPLICANTS:

Edward Lau, unmarried, tenant in severalty, whose mailing address is 46-069 Lilipuna Road, Kaneohe, Hawaii 96744.

LEGAL REFERENCE:

Section 171-13, Hawaii Revised Statutes, as amended.

LOCATION:

Portion of Government lands of Kaneohe located seaward of (1) 4-6-01:27 situated at Kaneohe, Koolaupoko, Oahu, as shown on the attached map labeled Exhibit A.

AREA:

5,929 square feet, more or less, to be determined by Survey Division, DAGS.

ZONING:

State Land Use District: Conservation

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

DHHL 30% entitlement lands pursuant to the Hawaii State Constitution: YES _____ NO x

Item D-6

EXHIBIT "A"

CURRENT USE STATUS:

Unencumbered

CHARACTER OF USE:

Right, privilege and authority to use, repair and maintain seawall, stairs and fill land purposes.

COMMENCEMENT DATE:

To be determined by the Chairperson.

CONSIDERATION:

One-time payment to be determined by independent or staff appraiser, subject to review and approval by the Chairperson.

LEASE TERM:

Fifty-five (55) years.

CHAPTER 343 - ENVIRONMENTAL ASSESSMENT:

During recent inspection, Coastal Land Program (CLP) staff's research determined the subject seawall was established before 1974 i.e. prior to the enactment of the environmental assessment law.

DCCA VERIFICATION:

Individual, not applicable

APPLICANTS REQUIREMENTS:

Applicants shall be required to

- 1) Pay for an appraisal to determine one-time payment; and
- 2) Provide survey map and description according to State DAGS standards and at Applicant's own cost.

REMARKS:

Mr. Lau has an offer on the property and hopes to have a closing soon after the Board approval. The survey map revealed the encroachment. This subject property does not have a pier and is not part of the Kaneohe Bay Piers Amnesty Program.

The Coastal Land Program (CLP) staff has determined that the issuance of an easement for the encroaching portion of the seawall and reclaimed land would have no adverse impacts on natural resources, including beach resources and therefore has no objections to the issuance of an easement (see CLP letter, Exhibit C). According to the Planning Office correspondence, the previous land owner applied for a CDUA but because it was not acted upon in a timely manner by Staff, the then Board Chairperson wrote that his

application was automatically approved on February 22, 1977 and the Department of Land and Natural Resources staff does not consider this encroachment a Conservation District violation.

Staff recommends the Board impose a fine of \$500 for the encroachment upon public lands pursuant to Section 171-6(12) HRS, since the encroachment was done without proper State Government authorization. The CLP does not consider this encroachment a Conservation District violation as an automatic approval was applied under Section 183-41.

Applicant has not had a lease, permit, easement or other disposition of State lands terminated within the last five years due to non-compliance with such terms and conditions.

RECOMMENDATION: That the Board

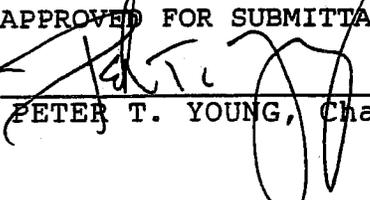
1. Subject to the Applicant fulfilling all of the Applicant requirements listed above, authorize the issuance of a 55-year term non-exclusive easement for the seawall, stairs and fill land purposes to Edward Lau under the terms and conditions cited above, which are by this reference incorporated herein and further subject to the following:
 - A. The standard terms and conditions of the most current term easement document form, as may be amended from time to time;
 - B. Review and approval by the Department of the Attorney General; and
 - C. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.
2. Impose a fine of \$500 for encroachment upon public lands without Government authorization pursuant to Section 171-6(12) HRS.

Respectfully Submitted,

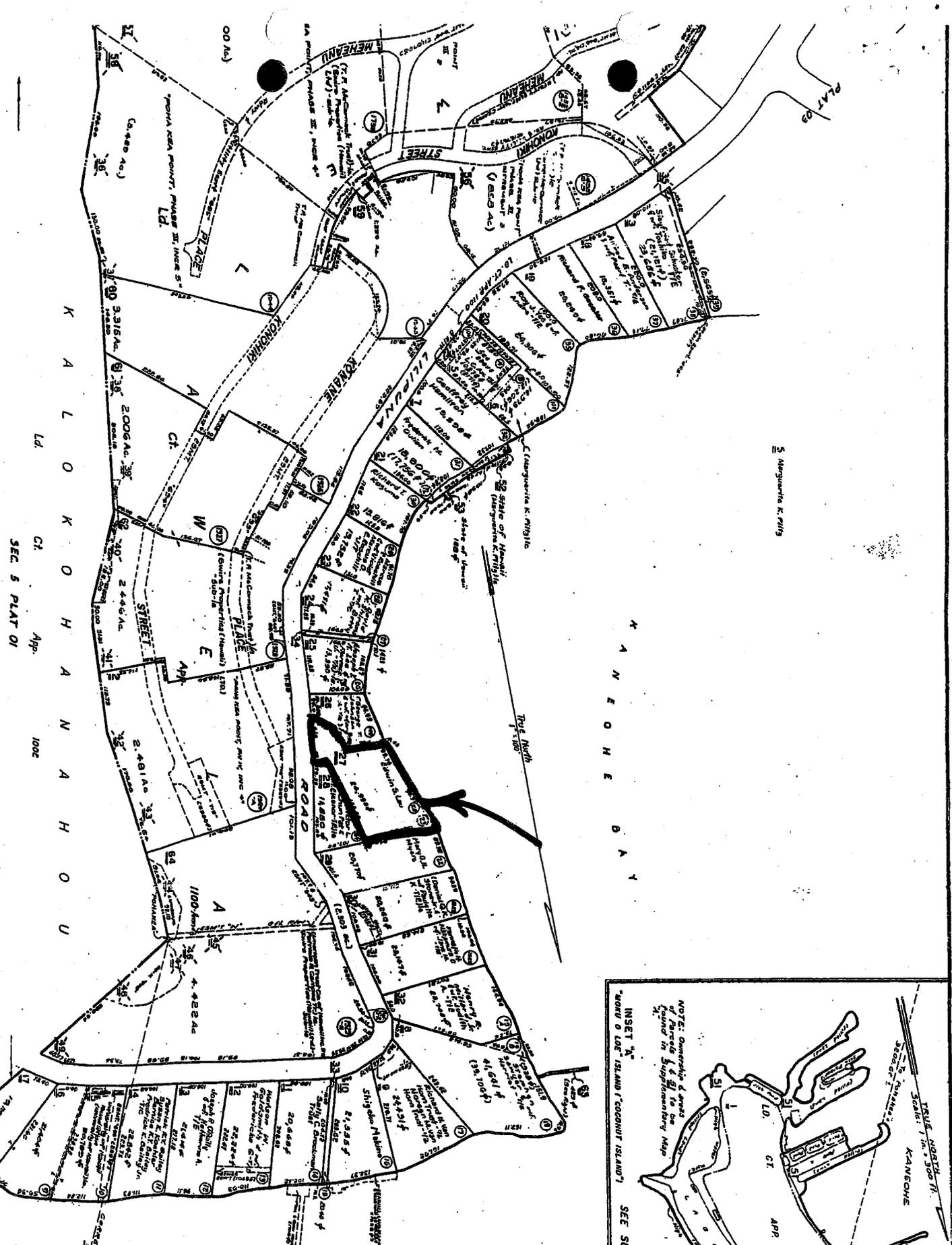


Al Jodar
Land Agent

APPROVED FOR SUBMITTAL:



PETER T. YOUNG, Chairperson



K A L O K O H A N A H O U
 LD CR App 100c
 SEC 5 PLAT 01

Note: All lots owned by R.P. Bishop Estate unless otherwise noted.

Parcel Grouped: 59 1/2
 TAXATION MAPS BY
 TERRITORY OF HAWAII
 TAX MAP
 FIRST DIVISION
 ZONE SEC. P
 4 6 0

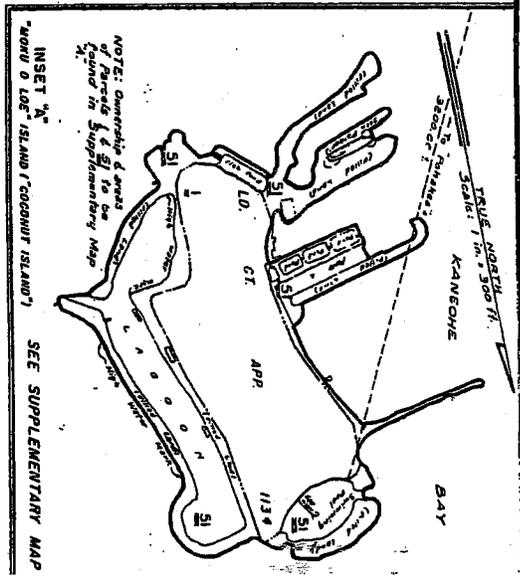
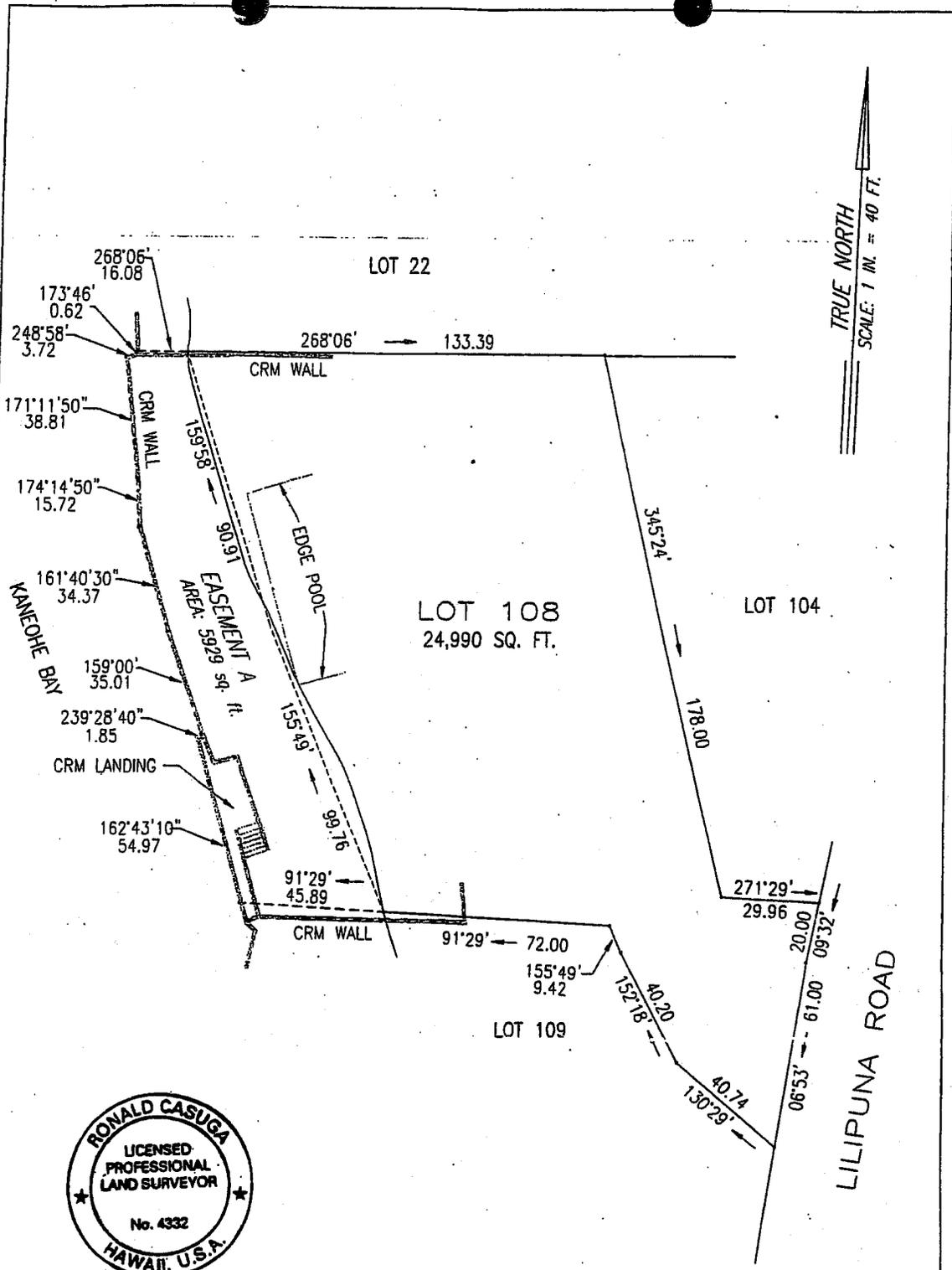


EXHIBIT A



This work was prepared by me or under my supervision

Ronald Casuga
 Licensed Professional Land Surveyor
 Certificate Number 4332

EASEMENT AREA
 LOT 108
 OF LAND COURT APPLICATION 1100
 (MAP 22)
 AT HEEIA, KOOLAUPOKO, OAHU, HAWAII
 TAX MAP KEY: 4-6-01:27

LINDA LINGLE
GOVERNOR



STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION
P.O. Box 621
HONOLULU, HAWAII 96809

DEC 20 2002

GILBERT S. COLOMA-AGARAN
CHAIRPERSON
BOARD OF LAND AND NATURAL RESOURCES

LINNEL T. NISHIOKA
DEPUTY DIRECTOR FOR
THE COMMISSION ON WATER
RESOURCE MANAGEMENT

AQUATIC RESOURCES
BOATING AND OCEAN RECREATION
COMMISSION ON WATER RESOURCE
MANAGEMENT
CONSERVATION AND RESOURCES
ENFORCEMENT
CONVEYANCES
ENGINEERING
FORESTRY AND WILDLIFE
HISTORIC PRESERVATION
KAHOOLAWE ISLAND RESERVE
COMMISSION
LAND
STATE PARKS

REF:PB:MM

File Number Encroachment: OA-03-21

Edward Lau
46-069 Lilipuna Road
Kaneohe, HI 96744

Dear Mr. Lau:

Subject: Shoreline Encroachment (Seawall and Fill Area) at 46-069 Lilipuna Road, Kaneohe, Oahu [TMK: 1-4-6-01:027]

Land Division, Planning Branch staff has reviewed the submitted documentation for this case. The encroachment in question is a seawall located Makai of the homeowner's property line. This structure is Makai of the metes and bounds of the parcel in question and thus constitutes an encroachment onto State of Hawaii land. The area of the alleged encroachment is approximately 5929 square feet. Staff has reviewed State records that indicate the Shoreline was certified on June 29, 1973. Furthermore, correspondence to the Department of Land and Natural Resources dated April 11, 1974 indicates the wall was not in existence in 1973 when the shoreline was certified, and was constructed nine months later in violation of County and State laws. However, a letter from the Department to John Legge dated February 22, 1977 indicates,

"From materials which we received earlier, we understand that you filed an application with the Department of Land and Natural Resources, Division of Land Management, in November 1973, requesting permission to construct the seawall. We further understand that you were assured by a staff member of the Department, who has since left for the Mainland, that the application would be forwarded to the Planning Office for processing and action by the Land Board. However, it has been discovered, no application concerning the seawall was received nor processed by the Planning Office.

In light of the foregoing events and the information you furnished, we have determined that your request/application filed, as such, with the Department on

1973 is automatically approved as stipulated by Section 183-41 of the Hawaii Revised Statutes." (Exhibit 1).

Due to the unusual circumstances surrounding this case, and the automatic approval of the seawall and fill area on February 22, 1977, the Department of Land and Natural Resources does not consider this encroachment a Conservation District violation.

The Board of Land and Natural Resource (BLNR) recently established a policy to allow the disposition of shoreline encroachments by either removal or issuance of an easement. In carrying-out this policy, the Department established criteria to guide decision-making over specific cases. The criteria are as follows:

1. Protect/preserve/enhance public shoreline access;
2. Protect/preserve/enhance public beach areas;
3. Protect adjacent properties;
4. Protect property and important facilities/structures from erosion damages; and
5. Apply "no tolerance" policy for recent or new unauthorized shoreline structures

In addition, the Department developed a "Shoreline Encroachment Information Sheet" that is intended to provide the State with additional information to guide the Department's decisions on the disposition of shoreline encroachments. This form has been completed and submitted. On November 26, 2002 staff visited the site to investigate the encroachments and to gather reconnaissance information to support a recommendation for either removal of the encroachments or issuance of an easement. Of primary importance are the Department's objectives to protect and preserve shoreline resources and shoreline access.

Surrounding Land Uses:

It was observed during the site visit that surrounding uses are residential. The Lilipuna Road subdivision shares a contiguous seawall.

Beach Resources:

CLP staff inspected the area. The tidal area is a shallow mud flat.

Public Access:

There is no public access to the beach.

Effect of Removing the Encroachment on:

Beach Resources: The removal of the encroachment would have no impact on public access. Public recreation such as fishing, diving and boating takes place offshore of the parcel.

Public Access: CLP staff has determined that public access would not be enhanced by removal of the encroachment.

Affect on Adjacent Properties: Removal of this portion of the wall would affect the two abutting landowners as the wall in question also fronts their parcels.

Upon review and careful consideration of the information gathered on this case, staff has determined that allowing the encroachment to remain through the issuance of an easement for the seawall and fill area would have no adverse impacts on natural resources, including beach resources. These improvements have existed since 1973 and became defacto approved according to the February 22, 1977 letter from the Department. Therefore, the Planning Branch has no objections to an easement request being processed. The Oahu District Land Office calculates the monetary amount required to dispose this use of State land through an easement. The landowner should note that they may be subject to an administrative penalty for unauthorized use of State land pursuant to section 171-6, Hawaii Revised Statutes.

We hope this letter helps resolve some of the outstanding issues regarding your property. Please feel free to contact Matthew Myers, of the Land Division, Planning Branch at 587-0382. Please contact the Oahu District Land Agent at 587-0433 regarding the processing of an easement.

Aloha,


Dierdre S. Mamiya
Administrator

Cc: Oahu Board Member
Oahu District Land Office
Chairperson's Office
Patti Edwards, DOCARE

LINDA LINGLE
GOVERNOR OF HAWAII



EXHIBIT "B"
AURA H. THIELEN
CHAIRPERSON
BOARD OF LAND AND NATURAL RESOURCES
COMMISSION ON WATER RESOURCE MANAGEMENT

**STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION**

POST OFFICE BOX 621
HONOLULU, HAWAII 96809

December 24, 2007

Certified Mail

Article No.0500 0003 2596 1377

John P. Dunham & Dana Lynn Kawano,
Trustees of the Dunham/Kawano Trust
c/o James Stone
Pitluck Kido Stone & Aipa
701 Bishop Street
Honolulu, Hawaii 96813

Dear Mr. Stone:

Subject: Arbitration of Value for 55-Year Term, Non-exclusive Easement, John P. Dunham & Dana Lynn Kawano, Trustees of the Dunham/Kawano Trust, Kaneohe, Oahu, Hawaii

Your letter dated February 2, 2007, indicated that you disagreed with the appraised value of the subject term easement and demanded arbitration. In that letter, you indicated that you had appointed George D. Hao as the applicant's appraiser in this proceeding. We sent a letter dated April 11, 2007, acknowledging the request for arbitration for the 55-year term easement by John P. Dunham & Dana Lynn Kawano, Trustees of the Dunham/Kawano Trust (hereinafter "the applicants"). In our letter was an outline of the arbitration process and a statement that, "The process should be completed in a reasonable time."

Several months passed without any communication to the State regarding the progress of the arbitration process. Mr. Hao had verbally indicated to Cyrus Chen, the Appraisal Manager, that he was going to proceed only pursuant to James Stone's direction. Mr. Chen spoke to Mr. Stone on the phone in October and was advised that Mr. Stone was going to prepare a Submission Agreement and have the applicant's appraiser, George Hao, proceed with the arbitration process. Mr. Stone requested a copy of the shoreline encroachment formula used to determine shoreline encroachment value. Mr. Chen emailed that to Mr. Stone on or around October 25, 2007. After no response, Mr. Chen followed up with an email inquiry on November 19, 2007 as to the status of the arbitration process. Again, after no response from Mr. Stone, Mr. Chen called Mr. Stone and left a voice message on December 11, 2007. As of the date of this

letter, there has been no response. Yamaguchi & Yamaguchi, Inc., the State's appraiser, has also indicated it has not received any contact from either Mr. Stone or Mr. Hao.

Since the applicant has not demonstrated to this Department any progress in the arbitration process, the Department believes it has no other option but to terminate the arbitration process and seek to rescind the Board's approval for the term, non-exclusive easement for seawall, stairs, and fill land. You will be contacted by the Oahu District Office regarding the date on which the Department will seek to rescind the Board's approval for the term, non-exclusive easement. Should the Board's approval be rescinded, the portions of the seawall, stairs and fill land encroaching on State property must be removed or the applicant will be subject to fines in accordance with Hawaii Revised Statutes, §171-6 (12).

If you have any questions regarding these requirements, please contact Cyrus Chen at (808) 587-0409.

Very truly yours,



MORRIS M. ATTA
Division Administrator

cc: Oahu District Branch
Central Files
John P. Dunham & Dana Lynn Kawano
Yamaguchi & Yamaguchi, Inc.

0-19

EXHIBIT "C"

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
Land Division
Honolulu, Hawaii 96813

April 23, 2004

Board of Land and Natural Resources
State of Hawaii
Honolulu, Hawaii

Statewide

Appraisal Methodology to Determine Easement Consideration for Shoreline Encroachments

PURPOSE:

The Land Division has been receiving an increasing number of cases of shoreline encroachments, such as seawalls, revetments, ramps, stairs, groins, and breakwaters. These structures constitute an encroachment onto State land as a survey map will show at least part of the structure's footprint extending past the private property boundary and onto the adjacent public lands. These cases arise primarily from shoreline certifications and the Kaneohe Bay Piers Amnesty Program (K-Bay Program). For shoreline certifications, by rule, the Department halts processing of the application until the encroachment is resolved either by removal of the structure or by obtaining an easement. For the K-Bay Program, the survey map for the pier will also identify any encroachments.

Upon discovery of a shoreline encroachment, the property owner is asked to complete a Shoreline Encroachment Information Sheet which asks certain questions about the encroachment, surrounding lands, beach resources and public access. The Office of Conservation and Coastal Lands (OCCL) reviews this information, conducts a site visit and then applies the Board's coastal policy on unauthorized shoreline structures. Based on the policy's criteria, OCCL will either recommend removal or retention of the structure. If the recommendation is to allow the encroachment to remain, Land Division staff prepares a Board submittal for a 55-year, non-exclusive easement to the abutting property owner.

Consideration for these easements is required by law. Our standard practice for easements is to hire an independent appraiser to determine the consideration amount with the applicant responsible for the cost of the appraiser. Most of these encroachments are relatively minor in size (100-200 square feet or less). Cost to hire an independent appraiser will run about \$2000 to \$3000 (commercial appraiser) while the easement consideration will range from \$500 to \$2000. As shown by these figures, it is hard to justify the high cost of the appraisal with the relatively low consideration amounts. Staff, therefore, has pursued an effort to develop a more streamlined, cost-effective approach to determining consideration for shoreline encroachment easements.

Staff hired Mr. Jan Medusky of Medusky & Co. to assist in determining an appropriate appraisal methodology upon which consideration for shoreline encroachment may be based,

as amended
APPROVED BY THE BOARD OF
LAND AND NATURAL RESOURCES
AT ITS MEETING HELD ON *1/24*
April 23, 2004

ITEM D-13

including reviewing the K-Bay Program methodology for determining pier lease rent.¹ Medusky & Co. understood that the task was to recommend an appraisal methodology that results in consistently reasonable market value conclusions and that, at the same time, is fairly easy to implement by the Department at a reasonable cost for the State and the applicants. Medusky & Co. delivered its consulting report dated March 23, 2004.

BACKGROUND:

The Medusky report commented on the K-Bay Program methodology approved by the Board in 2001 and used to determine the one-time payment for a term easement for the pier. An example of the K-Bay Program formula is as follows (items in **bold** are fixed factors):

Kaneohe Bay Piers Amnesty Program Methodology

Hypothetical Tax Assessed Land Value	\$20.00/sf
Submerged Land Discount	x 50%
Submerged Land Value	\$10.00/sf
Hypothetical Pier Area	x 400 sf
Pier Submerged Land Value	\$4,000
Land Rate of Return	x 4%/yr
Submerged Land Rent	\$160/yr
Present Value Factor (55 yrs; 4.0%/yr discount rate)	x 22.1086
Market Value	<u>\$3,537</u>

Medusky commented that this methodology follows a logical appraisal sequence with the only variables being the tax assessed land value and the pier area. This methodology is similar to the one recommended by Medusky with two exceptions: the use of the tax assessed land value and the present value factor.

Medusky concluded that the use of tax assessed land values does not result in consistently reliable conclusions because: 1) County assessments are typically based on market data that is 1-2 years old and therefore do not take into account changes in market prices, 2) Assessments are based on mass appraisal methodology, which may be necessary due to the large volume of properties and limited staff but which are not perceived by market participants as consistently accurate, and 3) County assessors are more concerned with total property value (land and improvements) while easement rights are analyzed based on land value. Medusky & Co. concluded that the use of tax assessed land values does not result in accurate market values that are fair to the State and the applicant.

Medusky provided five case study examples that compared appraised values for shoreline encroachment easements that were issued between July 2001 and January 2003. The easement consideration using the county tax assessed land value was compared with the actual appraised market value by an independent appraiser hired by the Department. The results were as follows:

¹ The Kaneohe Bay Pier Amnesty Program was established in 2001 to legalize the many unauthorized non-commercial piers adjacent to residential properties by issuing a lease to abutting owners. Each applicant pays the State a lump sum rent payment according to the methodology approved by the Board for a 55-year pier lease. Alternatively, the applicant can choose to pay for the cost of an independent appraisal.

<u>Indicated Lump-Sum, Advance Payment for 55-Year Term Easement</u>			
<u>Case Study</u>	<u>Based on Tax Assessed Value</u>	<u>Based on Appraiser's Land Value</u>	<u>Difference</u>
1	\$1,700	\$1,800	6%
2	\$2,000	\$2,300	15%
3	\$4,200	\$4,800	14%
4	\$8,500	\$10,600	25%
5	\$38,000	\$47,000	24%

As noted by Medusky, in every case, the indicated easement value based on the county's tax assessed land value is lower than that based on actual appraised land market value.

Medusky commented that the present value factor was based on a 4% per year net annual discount rate which is low by market standards and reflects payments in arrears, whereas, rent payments are typically made in advance. Medusky noted that their review of transactions involving leased fee interests in residential land reflect that investors in the open market typically require a discount rate from 7± to 9± percent on a net basis.

For shoreline encroachments, Medusky & Co. proposed a formula, similar to the K-Bay formula, for estimating the fee simple land value of the larger parcel. This methodology is shown next and followed by explanations for the different components.

Proposed Shoreline Encroachment Methodology

Fee Simple Unit Rate Land Value	\$ _____ /sf
Easement Land Area	x _____ sf
= Fee Simple Land Value	\$ _____
Disutility Factor	x 90%
= Perpetual Easement Value	\$ _____
Land Rate of Return	x 4%/yr
Annual Market Rent	\$ _____ /yr
Present Value Factor (55 yrs; 7% discount rate)	x 14.9157
Market Value	\$ _____

Medusky felt that the only reliable method to determine the fee simple land value is by actually completing an appraisal. He presented different alternatives including having in-house appraisal staff determine the land value or by outsourcing. Instead of hiring commercial appraisers as is the practice of the Land Division, Medusky recommended hiring residential appraisers actively involved in appraising oceanfront properties. Rather than completing a full appraisal of the easement value, these appraisers would only be determining the fee simple land value by completing "form" appraisals. Such form appraisals would likely cost \$450±, much less expensive than the \$2,000+ typically charged for full appraisal reports for shoreline easements.

A disutility factor is then applied to the land value to account for the encumbrance of the easement. A disutility factor is usually expressed as a percent and is multiplied by the fee simple land value of the easement area. Disutility factors are typically low for non-obtrusive easements such as a non-exclusive, underground pipeline easements running along a property boundary and high for exclusive easements such as an electrical substation. The disutility factor is then multiplied by the fee land value, which then results in the market value of a perpetual easement. Medusky has proposed using a 90% disutility factor to account for the encumbrance

of the easement but would be adjusted by in-house appraisers. He reasons that, for the most part, the shoreline easements are fairly obtrusive in that the Applicants have the use of the seawall, boat ramp, etc. which most times benefit only their properties. However, the easement is non-exclusive and the public has the right to use the easement area. From a practical perspective, however, others are not likely to make intensive use of the easement area due to its secluded location.

To calculate the value of a term easement, annual rent is then calculated. With a recommended 4% land rate of return, projected rental income is derived. As noted earlier, Medusky proposed a Present Value Factor based on a 55-year term at a 7% discount rate. Therefore, a Present Value (PV) Factor of 14.9157 would be utilized as opposed to the PV factor of 22.1086 used in the K-Bay formula.

In cases where the easement value is very low, Medusky suggested a Nuisance Value would be appropriate. The Nuisance Value typically accounts for inconvenience and administrative costs. Minimum annual rent for DLNR is currently \$156. Medusky & Co. indicates this Nuisance Value is low and provides market data involving properties statewide with Nuisance Values ranging from \$500 to \$6,000. Medusky & Co. suggests that when the easement value falls below \$500, a minimum Nuisance Value of \$500 be charged.

Medusky also included certain conditions attached to this methodology:

- 1) For unusual easements/properties, in-house appraisal staff should have the flexibility to adjust the disutility factor;
- 2) When market conditions change, a different discount rate reflective of the market should be used;
- 3) This methodology would be applicable to residential oceanfront properties and may be applicable to some commercial properties, however, because commercial properties vary significantly, the application of this methodology is questionable on a universal basis.

ANALYSIS:

In-house appraisal staff agreed with Medusky's proposed formula. However, staff continues to be concerned with the time and cost of hiring outside appraisers, even the lower cost residential appraisers. We anticipate many situations where the cost of the appraisal would still be relatively large compared to the easement consideration. Residential appraisals would cost about \$500 and this amount would still impose a relatively large burden given the easement values.

Therefore, staff identified additional alternative methods for determining fee simple land values along with Medusky's:

- 1) Hire independent appraiser
 - a) Residential appraiser for each property
 - b) Residential appraiser to set benchmarks for regional areas
 - c) Commercial appraiser to set benchmarks for regional areas

- 2) Conduct in-house appraisal
 - a) For each property
 - b) To set benchmarks for regional areas
- 3) Use county tax assessed land values

Exhibit A contains a grid displaying these alternatives with estimates of cost, accuracy and the pros and cons of each.

As shown by this grid, the better the accuracy, the higher the cost and/or time involved. Staff believes that not just one method should be used for all cases. For instance, to initially determine whether to charge the Nuisance Value, staff would want to use the tax assessed values. Where we have a grouping of easements in the same geographic area, e.g., Kaneohe Bay, we would probably want to hire a commercial appraiser to set a benchmark. If we have a single, large encroachment in East Honolulu, we will want to hire a residential appraiser for that specific property.

As a result, staff is recommending that the Board provide staff with flexibility in determining the appropriate method to determine the fee simple land value to plug into the formula.

Staff agrees that a Nuisance Value should be established and believes Medusky's proposed \$500 amount is fair and reasonable.

Staff also agrees with Medusky's conditions attached to this methodology (i.e., adjustments to disutility factor and discount rate and applicability only to residential properties) and have included them in the Recommendation.

RECOMMENDATION:

That the Board adopt the following appraisal methodology to determine term easement consideration for shoreline encroachments:

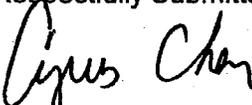
Fee Simple Unit Rate Land Value	\$ _____ /sf
Easement Land Area	x _____ sf
= Fee Simple Land Value	\$ _____
Disutility Factor	x 90%
= Perpetual Easement Value	\$ _____
Land Rate of Return	x 4%/yr
Annual Market Rent	\$ _____ /yr
Present Value Factor (55 yrs; 7% discount rate)	x 14.9157
Market Value	<u>\$ _____</u>

subject to the following terms and conditions:

- 1) This methodology shall only be used for shoreline encroachments abutting residential properties;
- 2) This methodology shall not be used for the sale of reclaimed lands;

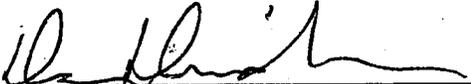
- 3) Where the estimated easement value is \$500 or less using the tax assessed land value, a Nuisance Value of \$500 shall be charged;
- 4) The staff appraiser, subject to review and approval by the Chairperson, shall have the authority to:
 - a) Select the most appropriate method to use for determining fee simple land value for each specific case;
 - b) Make adjustments for submerged versus fast land encroachments;
 - c) Make adjustments to the disutility factor based on the encroachment;
 - d) Make adjustments to the discount rate to reflect the market.

Respectfully Submitted,


Cyrus Chen
Appraisal Manager



APPROVED FOR SUBMITTAL:


Peter T. Young, Chairperson

Approved as amended. The Board amended the Recommendation Section by amending paragraph 3) to read as follows:

"3) Where the estimated easement value is \$500 or less using the tax assessed land value, a [~~Nuisance-Value~~] minimum rent of \$500 shall be charged;"

Cons

Pros

Accuracy

Cost

1) Hire Independent Appraiser		Cost	Accuracy	Pros	Cons
a) Residential appraiser for each property	\$450+ depending on complexity. Shoreline properties in different areas and different islands have their own unique characteristics.	Very Good	Better accuracy, less liability exposure for State, reflects current market value. Residential appraisers likely more familiar with market area and values.	Cost high relative to easement consideration amounts; lengthy appraisal process (at least 4 months). Form reports used by residential appraisers not the best format for discussion and analysis of the appraisal problem.	
b) Residential appraiser to set benchmarks	Most residential appraisers do not perform benchmark values for residential land, only individual form appraisals. They are not familiar with this methodology and it would be difficult on a form.	N/A	N/A	N/A	
c) Commercial appraiser to set benchmarks	\$3,000 to \$3,500 for an individual appraisal. Some firms such as Hallstrom would charge more (\$4,800 to \$5,500).	Good	Would get good work product with full analysis and comparables. DLNR would receive a set of data which they can keep as benchmark values for varying lot sizes if this was part of the appraisal contract; could then save money by doing in-house appraisals and adjusting comps.	Depending on how many easements could be included in one benchmark, cost may still be relatively high. Appraisal process would take 4-6 months. May work if they can do a bulk of appraisals in one market area at once. More time would be needed for multiple appraisals in different areas.	
2) Conduct In-House Appraisal					
a) For each property	Cost of appraiser's time and travel expenses, photos, equipment.	Very Good	Lower cost than hiring independent appraisers and more accurate than the tax assessed value method.	Lack of staffing (only one staff appraiser) a major issue and all but eliminates this alternative due to volume of easements. Need permission to inspect comp properties; potential access issues for appraiser.	
b) To set benchmarks	Cost of appraiser's time and travel expenses, photos, equipment.	Good	More cost efficient than other alternatives except tax assessed values and better accuracy than tax assessed values.	While less time involved than 2) a), still a concern about staffing resources required. Staff would need to research, analyze, and inspect all the comps. Data set may be large if there is a wide range of lot sizes and varying areas of the island or State.	
3) Use County Tax Assessed Land Values					
	\$0	Poor	No cost to either State or Applicant. Fastest method available.	As shown by Medusky's report, method is not accurate because of time lag, mass appraisal approach, and lack of emphasis on land vs. improvements value. Values will be consistently lower than market value.	